

**PRESENTATION BY THE ACTING TOWN ADMINISTRATOR
TO THE 2007 NATICK ANNUAL TOWN MEETING
REGARDING THE PROPOSED FISCAL 2008 OPERATING BUDGET**

This is a summary of the presentation made by the Acting Town Administrator at the May 29, 2007 Annual Town Meeting regarding the proposed Fiscal 2008 operating budget and the fiscal state of the Town. The operating budget was approved by Town Meeting as proposed.

We encourage Town Meeting members and all residents to familiarize themselves with the Town's budgeting process and fiscal state of affairs. This report will be available on the town's website www.natickma.gov and other related information will be added to the site as it becomes available.

A REVIEW OF THE BUDGET PROCESS

To facilitate dialogue over the coming months about the community's financial future, the budget presentation to Town Meeting began with a basic explanation of the budget process and noted that budgeting is an inexact and fluid process involving projection and ongoing updates of revenues and expenses. Typically the further in advance the forecasts are developed, the more conservative the approach. Early projections are often more gloomy than those developed later in the budgeting process.

Revenues

Generally speaking, there are three types of revenues:

1. Taxation – This is the only category subject to the limitations of Proposition 2 ½. The following chart depicts the formula for projecting available taxation revenue. The “new growth” figure reflects projected new development between tax dates (for FY 2008, this would be new development between January 1, 2006 and December 31, 2006).



TAXATION – Limited by Proposition 2 1/2

| | |
|---|----------------|
| FY 2007 Taxation | \$61,821,370 |
| Add 2 ½% | 1,545,534 |
| Add Anticipated New Growth | <u>618,214</u> |
| Projected Taxation Available for FY 2008 | \$63,985,118 * |

* Does not include funding approved through the debt exclusion override for the Wilson Middle School, forecasted for \$960,274 for FY 2008. Those funds are dedicated to the repayment of bonds that were issued for that school construction project.

2. Local Receipts – This is the only revenue category over which we have some control, notably through the amount we charge for licenses, fees, etc. Note that for FY 2008, Local Receipts is the revenue area where we will begin to see tax revenue from the Natick Mall. As certificates of occupancy are issued, we can impose a pro rata “supplemental tax” which is counted under Local Receipts, not Taxation.

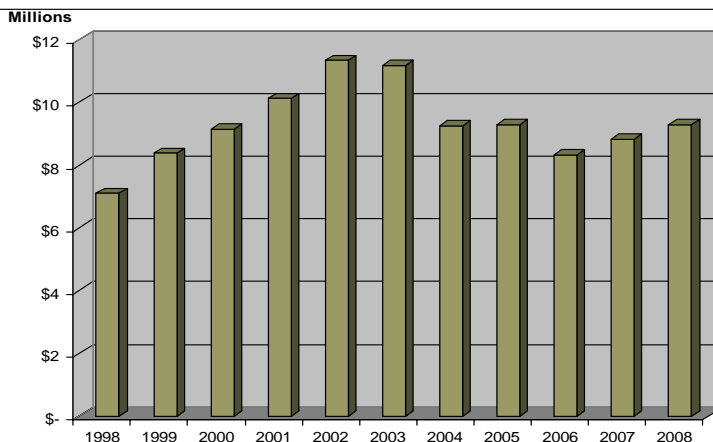
LOCAL RECEIPTS

Includes a variety of categories of revenue such as:

- ❑ Motor Vehicle Excise
- ❑ Penalties and Interest on Taxes
- ❑ Licenses and Permits
- ❑ Fees
- ❑ Ambulance Revenues
- ❑ Hotel/Motel Tax
- ❑ Pay as You Throw Revenues
- ❑ Investment Income
- ❑ Supplemental Tax
 - A pro rata taxation on properties for which an occupancy permit was issued during a fiscal year
 - We expect \$1 million in Supplemental Tax on the Natick Mall in FY 2008

3. State Aid has varied greatly in recent years, with increases as much as 18% but also with decreases as much as 17%. Projected FY 2008 Net State Aid is \$1.9 million lower than State Aid received in FY 2003, and only approximately equal to the amount received in FY 2004!

Net State Aid



Expenses

Generally speaking, there are two kinds of expenses:



EXPENSES:

- ☐ Operational Costs – Typically are predictable and don't vary much year to year other than wages

- ☐ Fixed Costs – Includes increases in

| | |
|------------------------------------|------------------|
| ▪ Health Insurance | \$972,145 |
| ▪ Property and Liability Insurance | \$ 11,200 |
| ▪ Pension Assessment | \$461,449 |
| ▪ Energy Costs | <u>\$256,576</u> |
| | \$1,701,370 |

- * Note that these fixed cost increases more than consume the projected Supplemental Tax from the Natick Mall!

USE OF RESERVES AND ONE-TIME FUNDING SOURCES TO BALANCE THE OPERATING BUDGET

In addition to use of recurring revenues of taxation, local receipts and state aid, non-recurring revenue sources and reserves were used to balance the approved FY 2008 operating budget. A basic principle on which most would agree is that ongoing operating expenses should be fully supported by reliable, recurring sources of revenue. To support ongoing expenses with one time funding sources or reserves is like paying your electric bill from your savings account. Eventually the savings will be depleted but the electric bills will continue to arrive.

The “savings accounts” we are using to balance the FY 08 budget include:

1. Free Cash – put very simply (and the actual method of calculation is far more complex), Free Cash is calculated at the end of each fiscal year, taking the free cash balance from the prior year, plus actual revenues received during that year, minus expenditures made. The FY 2008 operating budget proposes the use of \$2,832,878 in Free Cash.

Free Cash could be considered recurring in that a new amount is certified each year (Natick typically closes out with approximately \$4 million in free cash). But the use of these funds is best held off until later in fiscal year to meet unexpected needs such as unanticipated special education cost increases or dramatic increases in fuel or utility costs. Free cash is also appropriately used to fund the town's capital needs.

Here is some important guidance from the Massachusetts Department of Revenue regarding Free Cash:



MA. DEPARTMENT OF REVENUE:

“Maintenance of an adequate free cash level is not a luxury but a necessary component of sound fiscal management. Credit rating agencies and other members of the financial community expect municipalities to maintain free cash reserves, and make judgments regarding a community’s fiscal stability, in part, on the basis of free cash.”

An unofficial target for end-of-year free cash (after appropriations are made from the fund throughout the course of the year) is a minimum of ½% of general fund revenues, or \$551,000. Higher levels are recommended. Under the approved FY 2008 budget, our end-of-year free cash will be just over \$108,000.

2. Stabilization Fund – Our current balance in the Stabilization Fund is \$3.48 million; the FY 2008 budget utilized \$256,102 from this fund. There is no official Stabilization Fund target recommended by government budgeting advisory agencies, but many communities target 5% of general fund revenues; this would suggest a balance of just over \$5.5 million for Natick.



National Advisory Council on State and Local Budgeting:

- ❑ Stabilization Funds are to be used to address temporary cash flow shortages, emergencies, unanticipated economic downturns, and one-time opportunities. A prudent level of financial resources is recommended to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures.

Based on this guidance, Natick appropriately used Stabilization Funds in response to what was hoped to be temporary downturn in state aid, but persistent and ongoing use of these funds is contrary to recommended practice. In recent years we have used as much

as \$750,000 from this reserve to fund ongoing operating expenses. The resulting balance in the Stabilization Fund, after passage of the FY 2008 budget, is \$3.2 million, whereas balance of \$5.5 million would be suggested.

3. Overlay surplus

Each year's operating budget includes an overlay reserve account to fund property tax abatements and exemptions that may be granted in that fiscal year. The account is controlled by Board of Assessors. Once all exemptions and abatements for a particular fiscal year are resolved or can be reliably predicted, the overlay reserve funds may be declared by the assessors as overlay surplus.

Typically the overlay surplus is released incrementally, and is often used to fund capital needs. But this year the assessors were asked to and did release all potential surplus from FY 2006 and earlier; a total of \$1,226,024 was released from overlay surplus and used to balance the FY 2008 operating budget. Thus the availability of this funding source in future years is limited until the reserve is replenished.

4. Summary

Natick's initial use of reserves and one-time funding sources in response to abrupt reductions in state aid around FY 2003 was not necessarily an unsound decision, as it was hoped that the state would restore its commitment to local governments. Unfortunately, we are still waiting for that commitment to be fulfilled.

Here is a summary of our use of reserves & one-time revenues in recent years:

Use of Reserves and One-Time Revenues to Balance Operating Budget

| Fiscal Year | Free Cash | Stabilization | Overlay Surplus | Total |
|--------------------|------------------|----------------------|----------------------------|--------------|
| 2008 | \$2,832,878 | \$256,102 | \$1,116,024 | \$4,205,004 |
| 2007 | \$3,349,759 | \$400,000 | \$500,000 | \$4,249,759 |
| 2006 | \$2,910,651 | \$775,000 | \$675,000 | \$4,360,651 |
| 2005 | \$1,966,446 | \$750,000 | \$1,000,000 | \$3,716,446 |

The FY 08 operating budget uses a total of \$4.2 million in reserves and one-time revenues, consistent with their use in recent years. This could be characterized as a budget that exceeds ongoing available revenues by \$4.2 million. Our continued use of such funding sources has put the community in a very precarious financial position that appears unsustainable in future years. Further, by using these financial resources for ongoing operating needs, we've jeopardized our ability to keep pace with the town's capital needs, which will only cost the town more in the long run.

Here is a summary of reserve balances if all funding articles are approved as proposed (as of this writing, many articles – including several that request funding – have not yet been voted by the Annual Town Meeting. Specifically, the free cash usage identified below includes capital and other expenditures, in addition to free cash used to balance operating budget.)



Reserve Balances

❑ FREE CASH

| | |
|----------------------------|--------------------|
| Current Balance | \$4,137,917 |
| Proposed TM appropriations | <u>\$4,029,128</u> |
| Resulting Balance | \$ 108,789 |

❑ STABILIZATION FUND

| | |
|----------------------------|-------------------|
| Current Balance | \$3,482,960 |
| Proposed TM appropriations | <u>\$ 256,102</u> |
| Resulting Balance | \$3,226,858 |

SO WHERE DO WE GO FROM HERE?

The Board of Selectmen voted recently to form a Financial Planning Committee which will be made up of two members from the Board of Selectmen, two members from the Finance Committee, two members from the School Committee, the Town Administrator and the Superintendent of Schools. The primary objective of the Financial Planning Committee is to develop consensus regarding projected revenues and expenditures for coming fiscal years and to develop strategies to respond to projected shortfalls. This collaborative effort will be an essential first step to defining the problem and communicating alternative solutions.

The Committee will also establish Financial Management Policies to create a framework for future financial decision-making.

It is essential that we continue to assess operations to ensure that efficiency and cost-effectiveness are the standard throughout the government. We must also continue our efforts to educate and engage the public regarding the budgeting process and the short and long term financial challenges.

There are many positive efforts underway or planned, including:

1. Joining the newly established Regional Transit Authority
2. Analyzing the opportunity to join the state's Group Insurance Commission (subject to passage of legislation) for employee health care
3. Reviewing departmental fees to ensure we are maximizing these revenue opportunities

4. Improving the transparency of Capital Planning process including:
 - a. communicating the vast number of capital improvement and capital equipment needs that are not funded in a timely manner
 - b. establishing within the Financial Management Policies a reliable and realistic funding plan for capital needs
5. Assessing opportunities to improve energy utilization in buildings and facilities
6. Working with Natick's Retirement Board towards improvement of returns on investment, and advocating for passage of pending legislation that would allow the state to take over investment of these funds
7. Evaluating opportunities to regionalize services
8. Identifying opportunities to provide financial relief for taxpayers with a limited ability to pay tax increases

This is by no means a complete list but rather examples of efforts to effectively use all available resources to deliver high quality cost-effective municipal services and to creatively meet our financial challenges.

But even the best of efforts will not overcome the budgetary shortfall anticipated for FY 2009. As stated earlier, the FY 2008 budget exceeds available recurring revenues by \$4.2 million, we are not adequately funding the town's capital needs and we've significantly diminished the availability of reserves for FY 2009 and beyond.

Over the coming months, financial projections, service impacts, taxpayer impacts and more will be analyzed and communicated to the community as we look to address these financial challenges. I encourage the community to be informed and involved in this process, and look forward to working with the Selectmen, Finance Committee, other boards and commissions, town meeting and the community to meet these challenges.